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DEPT FOR D, AF A A/S CARTER, AF/SPG, AF/E, EEB/IFD
NSC FOR CHUDSON
DEPT PLS PASS USAID FOR AFR/SUDAN
DEPT PLS PASS TREASURY FOR OIA, USED IMF, AND USED WORLD BANK
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SUBJECT: GOVERNMENT OF SOUTHERN SUDAN FACES UNPRECEDENTED ECONOMIC CRISIS

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IC. Khartoum 129

11. (SBU) SUMMARY: The Government of Southern Sudan (GOSS) is on the cusp of a major economic crisis, hobbled by the absence of a strong fiscal policy and hostage to plummeting oil prices. After two years of seemingly limitless oil revenues and a burst in spending, the GOSS is making widespread budget cuts, has warned the SPLA that for the months of February and March troops would be paid food in lieu of salary, and is seeking a USD\$100 million loan from the Kenya Commercial Bank. The crisis lends increasing urgency to the North-South dispute over foreign exchange reserves, which is a separate but contributing factor to the sense of financial crisis. The fledgling sub-national government, shell-shocked by the economic tumult, has no real strategy to deal with the situation. While officials conceded that a crisis is at hand, their proffered solutions serve only to highlight the GOSS's naivete with respect to economic-policy planning. The SPLM sees the malevolent hand of the NCP in the current crisis, but the GNU is facing a similar crisis (though not quite as bad because the North is not as dependent on oil revenue) and while the NCP can be blamed for many things, it cannot be blamed for a fall in oil prices nor the lack of proper fiscal planning by the GOSS since 2005. However, the GNU's failure to transfer money to Abyei only exacerbates the problem. END SUMMARY.

2009 GOSS BUDGET: "DEFICIT BY DESIGN"

12. (SBU) On January 27, the Southern Sudan Legislative Assembly (SSLAs) approved the GOSS's US\$1.8 billion budget. The GOSS budget relies on oil-sale proceeds for 93 percent of its revenue. (In contrast, the Government of National Unity (GNU) in Khartoum depends on oil for 43 percent of its revenues.) GOSS Finance Minister Kuol Athian Mawien conceded to Acting CG Juba that, barring an uptick in oil prices, the 2009 budget is one of "deficit-by-design." Based on oil-revenue projections pegged to a baseline price of US\$50 per barrel, there is "no space to compensate" for the fact that Sudanese Dar crude oil currently sells at less than US\$15 per barrel. Projected February oil revenues (an estimated US\$16.2 million for the South) cover only eight percent of GOSS expenditures. The GNU informed Juba in mid-January that it could expect to receive only US\$76 million in revenues for the first quarter of 2009. Monthly GOSS salary and operating expenses alone average US\$75.6 million and US\$73.9 million respectively. GOSS capital expenditures -- the peace dividend on which the SPLM bases its credibility -- average US\$49.5 million per month. (NOTE: Non-oil revenue sharing between Khartoum and Juba for the first-half of 2008 yielded the South a scant US\$3.05 million, US\$1.9 million of which still had not been transferred to the GOSS by July 2008. END NOTE.)

FINGER-POINTING AMIDST MOUNTING FISCAL MIS-STEPS

¶3. (SBU) World Bank officials noted to Acting CG that the budget's approval some twenty-seven days into the GOSS fiscal year "will have a tsunami-like impact on the government's ability to control first-quarter spending and debt accrual." Not only must ministries grapple with the task of pushing delayed appropriations through an ill-equipped, limited-capacity procurement system, but they are scrambling to scale back expenditure choices that were based on dated projections of a 15 percent across-the-board budget increase. The decline in oil revenue - and Sudan's ability to find only one purchaser (China) for the majority of its crude for the months of November, December, and January -- forced the South's executive branch to abandon its earlier commitment of a "2009 budget top-up" in late December 2008, sacrificing not only hefty development initiatives in health, agriculture, and education in the South, but gutting the entirety of the "Abyei shadow budget." (NOTE: Although GNU is responsible for funding the Abyei Administration, GOSS ministries had initially designated US\$63 million their coffers to fund projects in the region which is still technically part of "North Sudan" but an area of key SPLM concern. END NOTE.)

¶4. (SBU) Ex-Finance Minister (current Information/Broadcasting Minister) Gabriel Changson Chang, Agriculture Minister Samson Kwaje, Legal Affairs Minister Michael Makuei, and Minister for Presidential Affairs Luka Biong Deng have all complained that Finance Minister Kuol Athian Mawien failed to explain to state governments and regional ministries in a "timely fashion" the degree and severity of the South's budget contractions. Finance Minister Athian rejects charges that he has been insufficiently transparent on the budget.

FINANCIAL FALLOUT SPREADING

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¶5. (SBU) Regardless of who is to blame, fallout can already be seen throughout the South. Juba Teaching Hospital staff learned January 19 that they would be placed on a one-week unpaid furlough. After two days of strikes, the Health Ministry reinstated pay and replaced the GOSS Health Undersecretary. Southern teachers, already owed a collective US\$10 million in back-pay, have been informed that they will suffer a 20 percent pay-cut in 2009. First Vice President of Sudan and GOSS President Salva Kiir Mayardit is seven-months behind in delivering on a series of "one-off commitments" to build schools, health clinics, and drill boreholes promised during his visits to Warrap, Unity, Upper Nile, and Northern Bahr el Ghazal states. As First Vice President of the GNU, Kiir is entitled to a US\$15 million "donations allowance." However, the GNU Finance Ministry is allegedly refusing to disburse donations for travel conducting in the South, even though this was initially authorized by the GNU Presidency. The GOSS Ministry of Finance has been tasked to "find" monies within the GOSS budget to preserve Kiir's public standing.

¶6. (SBU) Long-planned initiatives to support state-level decentralization, and efforts curb disproportionate government spending on salaries (which now amount for 61 percent of all GOSS expenditures), have been indefinitely delayed. Government "right-sizing" initiatives targeting ghost-workers and a bloated SPLA and "Organized Security Forces" (police, prisons service, wildlife services, and fire brigades) also have been impacted. Plans to transfer approximately 35,000 soldiers from the SPLA's ranks to the auspices of the "War Disabled, War Widows, and Orphans Commission" by the end of January have been delayed until April. GOSS pledges to the UN DDR Program for the South have been placed on an indefinite hold, further stalling "reintegration" of 25,021 ex-combatants into their original communities.

¶7. (SBU) The impact of the budget crisis is especially acute within the security sector, and places a disproportionate burden on state governments. The SPLA's 2009 budget remains at untenable 2008 funding levels, although that level provided insufficient payroll coverage last year and now also must cover six-months of food and fuel carry-over costs. Juba requires US\$15.6 million on hand each month to transfer to each of the South's ten states so that state governors can pay the Organized Security Forces. The Inspector General of the Southern Sudan Police Service (SSPS) told Acting CG

January 23 that not only does he not have a solution to the fact that the GOSS will not have enough funds to pay approximately 60,000 police in February, but he also bitterly complained that he never saw the Ministry of Internal Affairs budget until after it was tabled at the Assembly.

ARREARS IMPEDE GOSS FINANCIAL AUTONOMY

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¶8. (SBU) The South's first-time accrual of arrears imperils Juba's attempts to secure external financing or development loans independent of Khartoum. Frustrated by the pace of Multi-Donor Trust Fund disbursals, the GOSS spent months researching the possibility of securing development loans from the IMF, the World Bank, and commercial entities. GOSS Finance Minister Mawien fast-tracked the initiative in March 2008 after Beijing reneged on a June 2007 pledge to provide direct credit to Juba, citing the lack of collateral. (NOTE: This reportedly marked the eighth time the GOSS had suffered a bilateral loan commitment breach. To date, only India has fulfilled such a pledge with a US\$50 million agro-loan.
END NOTE.)

¶9. (SBU) Seeking to improve Juba's credit-worthiness, Mawien claimed that he invoked the terms of a December 2007 Memorandum of Agreement between the GNU and the GOSS regarding Central Bank of Sudan (CBOS)/Bank of Southern Sudan (BOSS) relations to justify the transfer of foreign-currency reserves in the BOSS into a GOSS off-shore account in Bahrain, and then again to Stanbic Commercial Bank in Kenya in 2008 (ref. B). Juba's strategic reserve holdings in Stanbic now total over US\$500 million, earning a US\$9 million five-month investment-return. (Note: The SPLM State Minister of Finance in the GNU has told us that this action was against the terms of the CPA and that the money should be returned to the CBOS. This issue looms as yet another factor that could contribute to a simmering crisis between the CPA parties. End note.)

¶10. (SBU) Although Kenya Commercial Bank (KCB), Stanbic Bank, and Citibank all have expressed interest in issuing commercial loans to the GOSS, only Citibank has committed to issuance of financial guarantees for the GOSS to overseas parties - pending issuance of an OFAC license by the U.S. Treasury. Moreover, upcoming GOSS negotiations with KCB regarding Juba's first-ever receipt of a US\$100 million loan will, if granted, only cover GOSS salary and

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operating expenses for one month.

FOREIGN EXCHANGE DROUGHT

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¶11. (SBU) Mawien complained that Khartoum's refusal to transfer additional foreign-currency to Juba not only undermines GOSS efforts to secure external financing, but it necessitates tapping into the strategic reserve for certain purchases and payments (food imports, purchase of weaponry, maintenance of GOSS Liaison Offices overseas). The Finance Minister repeatedly pledged to SSLA members during budget debates that the GOSS learned valuable lessons from the 2005-2007 period, when Mawien's predecessors (one of whom was sacked on corruption charges) blew US\$465.5 million from the South's strategic reserves. (NOTE: Mawien himself authorized over-expenditures of approximately US\$23 million following his July 2007 appointment. END NOTE.) 2008 marked the first time that the Southern Government was able to make consistently contribute to its reserve holdings, because of the oil bonanza - and the Finance Minister cautioned the SSLA against forcing Juba to abandon that legacy. "By the end of 2007 the GOSS had almost no savings at all - we have made every effort that the 2009 budget is balanced, so that we do not go into deficit and use up the money we have saved this year and we can protect our reserves," he said.

¶12. (SBU) The CBOS withholding of additional hard-currency from Southern Sudan has placed an additional weight on the BOSS. BOSS President Elijah Malok told Acting CG January 2 that insufficient dollar-reserves forced the Bank to transfer US\$20 million from the 2008 budget back to the South's strategic reserve at the end of the Sudanese fiscal year. Alok noted that the Bank was unable to process all of the GOSS's financial obligations for the month of

December despite the BOSS calling-in the totality of its hard-currency commitments to Juba's four commercial banks. CBOS Assistant Governor Kornelio Koriom Mayik told Acting CG on January 16 that the BOSS had exhausted the totality of its hard-currency stock. "The only dollars in the South are those at KCB," he claimed.

FOREX CRISIS: SPLM - CARPE DIEM

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¶13. (SBU) In Juba January 27, Charge Fernandez urged the SPLM to seize the opportunity provided by increasing ICC pressure on Bashir and the NCP to resolve North/South foreign exchange crisis. "We worry that the GOSS will be placed in a dangerous situation, one that eventually places you at the mercy of the National Congress Party," he cautioned. The SPLM's strength and the ability of the GOSS and the CPA to avoid the fate of the systemic dismantling of both the ESPA and DPA rests in Wealth Sharing Agreement, and the South's ability to collect oil proceeds (plus the South having its own standing army). The financial crisis is the South's Achilles Heel, which Charge predicted the NCP could aggressively take advantage of as pressure on Khartoum intensifies. Minister for Regional Cooperation Benjamin agreed, asserting that the NCP's repeated claims that the BOSS is a subordinate entity of the Central Bank are without merit. "The NCP has played a card that is very transparent - it is a direct and dangerous threat to the CPA to undermine the South's economic stability." (Note: Benjamin failed to note that the major elements of the problem, collapsing oil prices and poor financial management in Juba, are not caused by the malevolent regime in Khartoum. End note.)

¶14. (SBU) Presidential Affairs Minister Luka Biong Deng noted similar concerns. Deng reviewed GOSS discussions with World Bank President Robert Zoellick in Washington, DC in January 2009 that led the GOSS to believe that, with the lobbying assistance of key donor allies, the World Bank would be inclined to consider Heavily Indebted Poor Countries (HIPC) assistance for Southern Sudan. (NOTE:

World Bank Country Representative Laurence Clarke told Deng on February 3 that he believed that securing HIPC for a sub-national entity like the GOSS would be a lengthy and ultimately fruitless process, and counseled the GOSS to look to more viable short-term solutions. END NOTE.) While the CDA was non-committal about U.S. support for GOSS HIPC-efforts, he did stress that the USG already had warned the NCP informally that should Khartoum attempt to use its budget crisis to squeeze an already strapped Juba, "we would view it as an act of subterfuge - and sabotage - to the CPA."

¶15. (SBU) Both Deng and Benjamin noted that the foreign exchange crisis, which has remained under the Sudanese political radar for the last nine months as a "technical matter," is now being elevated to the level of the joint SPLM/NPC Executive Committee Talks now that the fall in oil prices has begun to bite. Helmed by GOSS Vice President Riek Machar and GNU Vice President Ali Osman Taha, the transfer of the forex debate will at least ensure that President

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Kiir will be kept better-informed of the parameters of that particular part of the crisis. CBOS Assistant Governor Mayik privately complained to Acting CG that attempts by the BOSS to place the forex crisis on the agenda the GNU Presidency were repeatedly overtaken by "political events of a more-pressing nature" - namely elections and the 2011 Referendum issues still under debate within the Executive Committee.

COMMENT

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¶16. (SBU) While the severe economic impact of the drop in world oil prices is only now becoming clear, this crisis has been looming for months. Although 2009 GOSS oil revenues are sharply below last year's, they are projected to be approximately the same as in 2007, so lack of budget discipline is in fact a greater problem than are falling oil prices. The fact remains that, since 2005, the GOSS has gone through money like a sailor on shore leave. Neither of these problems has been a secret (Finance Minister Mawien highlighted both in his FY 2008 budget address to the SSLA), but the GOSS has proved unable or unwilling to correct either one. The GOSS seriously overspent its budget in the early months of both 2007 and 2008, but

was able to finish both years in the black, thanks to its oil revenue windfall. The 2008 supplemental increased the budget by 1,478 percent. That luxury is no longer available, but based on past performance, there is little room for optimism that the GOSS will be able to restrain its profligate spending. The dispute over CBOS/BOSS forex holdings is really a separate issue, although the GOSS' increasing desperation make it unlikely to give any ground on this issue in order to hold on to any foreign exchange it can. The GOSS' failure to find other revenue sources, lack of fiscal discipline and poor budget management leave it at the mercy of the GNU and the NCP, which may be one of the reasons the SPLM has been relatively muted in its statements regarding the looming ICC indictment of President Bashir. Salva Kiir has been very successful in buying a level of progress and social peace in South Sudan unprecedented in the region's history and wealth sharing has been one of the major successes of the CPA. If there is no wealth now - because of the decline in oil revenues - and little savings, because of GOSS's lack of fiscal discipline, South Sudan, with its 150,000-man army, begins to enter dangerous, uncharted waters in ¶2009.

FERNANDEZ